Case No. 01-0638

In The
Supreme Court of the United States

STATE ENGINEERING ASSOCIATION, et al.

Petitioners,

v.

GEORGE LIGHTBOURN, Acting Secretary of the Wisconsin Department of Administration, et al.

Respondents.

On Petition for Writ of Certiorari to the
Supreme Court of the State of Wisconsin

RESPONDENTS' BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Whether the Wisconsin Supreme Court correctly determined that participants in the Wisconsin Retirement System have no contract right or property interest in determining the timing and application of investment earnings to employer contributions when the employers' ultimate funding obligations are not altered, the investment earnings are used for Trust Fund purposes, and the change will not render the Wisconsin Retirement System actuarially unsound.

2. Whether the Wisconsin Supreme Court correctly determined that modifying the timing of employer contributions does not constitute either a taking or a violation of the contract rights of participants in the Wisconsin Retirement System.

SUMMARY OF OPPOSITION

The State Respondents respectfully ask this Court to deny the petition for a writ of certiorari to review the decision of the Wisconsin Supreme Court for at least two reasons. First, the petitioners attempt to manufacture a conflict where none exists between various state court decisions. Second, the petitioners also attempt to manufacture a "radical departure from precedent" which misapprehends the decision in this case. The decision does not merit review by this Court.

STATEMENT OF THE CASE

Petitioners seek review of only one portion of the Wisconsin Supreme Court's decision declaring constitutional a number of legislative revisions to the Wisconsin Retirement System passed as part of the Pension Improvement Bill, 1999 A.B. 495, which became 1999 Wisconsin Act 11 ("Act 11"). The Wisconsin Supreme Court determined that sections 27(1)(a) and (1)(b)1 of Act 11, which designate a portion of monies in the employer reserve account for an "employer credit," are constitutional and do not violate petitioners' contractual rights or property interests in the Wisconsin Retirement System.

A. Procedural History of the Case

Act 11 improved benefits and made certain changes to the Wisconsin Retirement System ("WRS"). On December 23, 1999, the Employe Trust Funds Board (the "ETF Board"), the Department of Employe Trust Funds (the "DETF") and its Secretary, Eric Stanchfield (collectively, the "ETF Petitioners") filed a Petition for Leave to Commence an Original Action, naming as respondents Secretary of the Wisconsin Department of Administration George Lightbourn and Wisconsin Treasurer Jack C. Voight ("State Respondents"). The Petition sought declarations regarding the constitutionality of various provisions of Act 11.

The Wisconsin Education Association Council and certain of its members (collectively, "WEAC") moved to intervene as respondents. The Wisconsin Professional Police Association and several of its members (collectively, "WPPA") and the State Engineering Association and several of its members (collectively, "SEA") separately moved to intervene as petitioners.

On February 10, 2000, the court issued an order denying ETF Petitioners' Petition and granting all motions to intervene. WPPA and SEA were designated as petitioners; the State Respondents and WEAC were designated as respondents. The WPPA Petition was designated as the complaint in the case, and the court permitted the SEA to supplement the WPPA complaint.

By order of May 25, 2000, the Wisconsin Supreme Court granted the WPPA and SEA Petitions for Leave to Commence an Original Action. The court adopted the parties' Stipulation of Facts and Stipulated Exhibits. Briefs were filed and the Wisconsin Supreme Court heard extended oral argument. On June 12, 2001, the Wisconsin Supreme Court issued its ruling declaring constitutional all challenged portions of Act 11.

B. Statement of Facts[1]

1. Creation of and Funding the Wisconsin Retirement System

The WRS is the product of many years of legislative action on public employee retirement in Wisconsin. App. 7 ¶ 7.[2] The WRS consists of about 461,000 participants: about 255,000 active employees (who are divided into several categories), 103,000 annuitants, and 103,000 "inactive participants" (former participating employees who have not yet become annuitants). App. 9 ¶¶ 11-13. The WRS is supported by nearly 1,200 different employers, including the agencies of the State of Wisconsin and various local governmental units. *Id.*

[1] As petitioners acknowledge, the Wisconsin Supreme Court made its determinations on stipulated facts, the most pertinent of which are included.

[2] References to petitioners' appendix are designed "App. ___."

The WRS is funded by contributions from employers and employees, and the interest and other investment income earned on these contributions (the "Trust Fund"). App. 9 ¶ 13. Required employee contributions are set by statute as a percentage of an employee's income. Employees may also make voluntary contributions. App. 10-11 ¶¶ 14-15.

Employer contributions are determined differently. Employer contribution rates are not set by statute. Instead, they are determined annually as part of an actuarial evaluation of the WRS. Each year the WRS consulting actuary evaluates the funding requirements for the system to meet the costs of estimated future retirement benefits. The annual contribution rate developed for employers is the amount sufficient to fund over time the projected benefit costs, net of all revenues received from employee contributions and investment earnings credited as current income. App. 11-12 ¶ 16. Nothing in Act 11 changed this obligation to ensure funding of promised WRS benefits. App. 74-75 ¶¶ 174-76.

Employers are required to pay contributions both for current service as well as for any unfunded prior service liability ("unfunded liability") owed to the WRS. App. 13-14 ¶¶ 19-20. An employer's unfunded liability is the result of two factors: (1) a grant of credit under the WRS for services rendered by an employee before the employer joined the WRS; and (2) an increase in benefits for an employee's prior service created by legislation enhancing benefits. When the legislature authorizes increased benefits for WRS participants and retroactively applies the benefit increase to prior service, employers may be forced to make additional contributions to the employer reserve to fund the retroactive benefits increase. Employer contribution rates for the payment of unfunded liability are currently amortized over 40 years. *Id.*

2. Employee, Employer and Annuity Reserves

The fixed retirement investment trust, which is the relevant portion of the Trust Fund for purposes of this case, contained at the relevant time about $48.7 billion. Within the fixed

retirement investment trust, four accounts or reserves are most pertinent to this case: the employer accumulation reserve (holding about $11.5 billion), the employee accumulation reserve (holding about $10 billion), the annuity reserve (holding about $14.8 billion) and the transaction amortization account (holding about $11.5 billion). App. 17-25 ¶¶ 24-36.

The employee reserve holds the employee contributions. Within the employee reserve, each participant has his or her own individual account. The employer reserve holds the contributions required of the employers. The employer reserve is maintained without regard to the identity of any individual employer or participant. The annuity reserve holds the monies to be distributed to annuitants once they begin to draw either a money purchase or formula benefit. App. 104-107 ¶¶ 11-18.

When an employee leaves public service and begins to draw a benefit, the entire balance of that employee's account in the employee reserve is transferred to the annuity reserve. In addition, an amount is credited to the annuity reserve from the employer reserve "that when increased by an interest assumption of 5% annually will fully finance the [employee's] future benefit payments." App. 21-22 ¶ 32. The dollars transferred from the employer reserve are not earmarked for any specific participant until they are deposited into the annuity reserve.

3. Annuity Benefits

Upon retirement, an annuitant will always receive the higher of the money purchase or the formula benefit amount. Under the formula benefit, eligible WRS participants may receive a specific retirement benefit calculated pursuant to a formula. Under the money purchase benefit, WRS participants are guaranteed that the minimum annuity benefit they will receive will equal the sum of the participant's accumulated contributions (including interest) plus an amount from the employer reserve equal to the participant's accumulated required contributions. App. 103-

104 ¶¶ 7-11. The amount of money in the employer reserve does not affect the amount of the annuity which an annuitant is entitled to receive. App. 74 ¶ 172.

4. The Transaction Amortization Account

The transaction amortization account, or "TAA," is more of an accounting mechanism than a separate account. All realized and unrealized gains and losses of the fixed retirement investment trust are credited to the TAA. Prior to enactment of Act 11 (which eliminated the TAA and replaced it with a different but similar mechanism), 20% of the TAA balance was distributed annually to the Trust Fund, with the distributions divided proportionately among the accounts and reserves. This distribution generally approximates 20% of the gain or loss on each reserve or account (employer, employee and annuity) over and above the expected rate of return for the year from investing the dollars in those accounts and reserves. The purpose of the TAA is to smooth the impact of investment gains and losses on the accounts and reserves of the Trust Fund. This tends to create greater predictability for determining the contributions necessary to fund benefits and to stabilize dividend distributions to annuitants. App. 22-23 ¶¶ 33-34.

5. The Challenged Provisions of Act 11

The portion of Act 11 at issue in the petition accelerates distribution of monies from the TAA into the employer, employee and annuity reserves. In addition to the usual annual 20% distribution, Act 11 accelerated distribution of another $4 billion from the TAA into the three reserves. The $4 billion accelerated recognition was credited proportionately to the employer ($1.236 billion), employee ($1.064 billion) and annuity ($1.608 billion) reserves. App. 70 ¶ 162. This accelerated recognition was made to fund a portion of the cost of paying for certain WRS benefit enhancements which were also part of Act 11. App. 122 ¶ 56. Even if this accelerated recognition had not been made, the $4 billion would have been recognized into the employer,

employee and reserve accounts in the five years after the effective date of Act 11. App. 111 ¶ 25.

Act 11 provided that $200 million of the $1.236 billion increase in the employer reserve resulting from the $4 billion TAA distribution be used to establish employer credits. App. 29. These credits permit suspension of payments for unfunded liability. Employers who have already paid off their unfunded liability or who have credits in excess of such unfunded liability can suspend their payment of the employer required contributions for current liabilities until their credits are exhausted. After an employer's credits have been exhausted, the employer is required to resume payments to satisfy required contributions and any remaining unfunded liability. App. 29-30. The application of this credit does not negate the employers' obligation to provide sufficient funding to meet WRS benefit commitments. App. 74, 75.

6. After Act 11 is Implemented, the Trust Fund Remains Actuarially Sound

Of critical importance is the fact admitted by all parties, including petitioners, that the Trust Fund is not financially troubled, and implementation of Act 11 by itself will not make it so. App. 121 ¶ 54. The Wisconsin Supreme Court further found that the Trust Fund, as changed by Act 11, will be actuarially sound. App. 135. The petitioners specifically stated that the provisions of Act 11, including this employer credit, "do not leave the Trust Fund in a financially troubled condition, now or in the future." App. 135.

C. The Wisconsin Supreme Court Decision

The Wisconsin Supreme Court's decision describes the rights of participants in the WRS. It is well-established that "[p]roperty interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Webb's Fabulous Pharmacies, Inc. v. Beckwith,* 449 U.S. 155, 161 (1980) (citing *Board of Regents v. Roth,* 408 U.S. 564, 577 (1972)). Drawing

on the language of the statutes – which create the "trust document" – as well as on prior case law, the Wisconsin Supreme Court explained the general framework within which WRS participants' contract rights and property interests are defined. App. 49-57.

1. Benefit Commitments, Subject to Legislative Reservation

Every participant has interests and rights in the WRS. App. 49. Every participant is either an annuitant (one already receiving benefits under the WRS), or a potential annuitant (with an individual account in the employee reserve). *Id.* Each participant has a property interest in his or her annuity or individual account, and a right to protect that interest.

In addition to this narrow individual interest, each participant has a broad property interest in the WRS as a whole. *Id.* However, because there are multiple categories and subcategories of participants, different participants have different interests. Nonannuitants have different interests than annuitants. The Wisconsin Supreme Court very carefully explained why it differentiated between these various groups and their rights in the WRS in its previous decisions. The Court did not ignore or overrule its prior holdings. App. 50-51. This case presented facts and issues not considered in past decisions.

The property interests and contract rights of participants in the WRS derive from the statutes. Under Wis. Stat. §§ 40.01 and 40.19, the legislature defined the purpose of the Trust Fund, as well as the protected property interests and contract rights of participants therein. In general, when the legislature passes legislation, it retains the right to modify or rescind that legislation and cannot bind future legislatures to its actions. The presumption is that a law "is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise." *Dodge v. Board of Educ.*, 302 U.S. 74, 78 (1937) (cited with approval in *Morrison v. Board of Educ.*, 237 Wis. 483, 487, 297 N.W. 383

(1941)). The legislature limited that unfettered legislative prerogative when it created Wis. Stat. ch. 40, the blueprint for the current Wisconsin Retirement System.

Section 40.19(1) of the Wisconsin Statutes establishes certain contract rights as follows:

> *Rights exercised* and *benefits accrued* to an employee under this chapter *for service rendered* shall *be due* as a contractual right and shall not be abrogated by any subsequent legislative act. *The right of the state to amend or repeal, by enactment of statutory changes, all or any part of this chapter at any time, however, is reserved by the state* and there shall be no right to further accrual of benefits nor to future exercise of rights for service rendered after the effective date of any amendment or repeal deleting the statutory authorization for the benefits or rights. This section shall not be interpreted as preventing the state from requiring forfeiture of specific rights and benefits as a condition for receiving subsequently enacted rights and benefits of equal or greater value to the participant.

Section 40.19(1) requires a balancing of interests. On the one hand, a participant has certain contractual rights that may not be abrogated by subsequent legislative acts. On the other hand, the legislature retains the right to amend or repeal any part of the trust document (Wis. Stat. ch. 40), and there is no right to further accrual of benefits nor future exercise of rights for service rendered after the effective date of amendment thereof. App. 52-53. Moreover, the state is not prevented from requiring forfeiture of specific rights and benefits as a condition for receiving subsequently enacted rights and benefits of equal or greater value. *Id.*[3] The reservations retained by the legislature in § 40.19(1) are, as the Wisconsin Supreme Court held, "just as much a part of the contract as any other provision in Chapter 40." App. 80 ¶ 196.

All of this begs the question, of course, of what "rights and benefits" are granted and protected. The Wisconsin Supreme Court concludes that § 40.19(1) provides a limited contractual right that does not extend to every provision of ch. 40 or every procedural or substantive aspect of the WRS – but only to "rights exercised and benefits accrued which are due

[3] The court has found that "[n]o participant's accrued benefits are abrogated, damaged or threatened. Most participants will receive substantial benefit improvements." App. 64 ¶ 142.

for service rendered." App. 53 ¶ 111. This would include a right to an accrued monetary benefit; however, it would not include a right "to maintain some operating procedure in the WRS that had existed during a period that the participant was rendering service." *Id.*

2. Proper Use of Trust Fund.

In general, "[t]he purpose of pension plans is to give the employees a protected interest in postretirement income." *Association of State Prosecutors v. Milwaukee County*, 199 Wis. 2d 549, 563, 544 N.W.2d 888 (1996). In addition to the specific right to rights exercised and benefits accrued, WRS participants also have property interests arising from Wis. Stat. § 40.01, which defines the purpose of the Trust Fund. The Trust Fund is created, in part, "to aid public employees in protecting themselves and their beneficiaries against the financial hardships of old age and death." The trust fund "is a public trust and shall be managed, administered, invested and otherwise dealt with solely for the purpose of insuring the fulfillment at the lowest possible cost of the benefit commitments to participants . . . and shall not be used for any other purpose." App. 54-55.

Like § 40.19(1), this provision reveals a certain internal tension, because it requires that benefits be fulfilled, but "at the lowest possible cost." As the Wisconsin Supreme Court points out, this is different from a mandate to maximize benefits irrespective of cost. App. 55 ¶ 115.

Section 40.01 also sets forth specific safeguards to participants. First, trust fund money must be used for proper trust fund purposes. App. 55 ¶ 116. Second, legislative actions affecting the WRS must be consistent with the stated objectives of the trust. App. 56 ¶ 119. Third, the ETF Board must deal with the WRS in the same faithful manner as trustees would administer any trust; they must exercise diligence, prudence and absolute fidelity in managing trust assets. Act 11 reaffirms the position of the Board to that effect. 1991 Wis. Act 11, § 27(3).

App. 139 ("Notwithstanding any provision in this act, the employe trust funds board shall retain the authority to maintain proper actuarial funding of the Wisconsin retirement system").

3. Integrity and Security of Trust Fund.

Finally, the Wisconsin Supreme Court cites as a third source of property interests and rights the integrity and security of the retirement funds. The statutes confer upon the participants the right to protect their individual accounts from either abrogation or dissipation. App. 57 ¶ 121; *Association of State Prosecutors v. Milwaukee County*, 199 Wis. 2d 549, 544 N.W.2d 888 (1996).

Applying these principles to the claims made by petitioners, including claims relating to the creation of the employer credit, the Wisconsin Supreme Court properly concludes that Act 11 is consistent with the contract rights and property interests of the WRS participants.

REASONS FOR DENYING THE WRIT

I. THE WISCONSIN DECISION DOES NOT CREATE CONFLICTS WITH DECISIONS OF OTHER STATE COURTS

Many state courts have considered challenges to legislative changes or other actions affecting their public employee pensions systems. In some cases those changes have been upheld and in others they have not. Although generalizations can be made about how various states analyze and review their pension systems, the decisions are not uniform in defining the rights, benefits and interests of various classes of participants in those systems. The reason for that is not sinister, is not the result of "judicial tampering with established property interests,"[4] and does not cry out for "correction" from this Court.

In an egregious misrepresentation of the Wisconsin Supreme Court's decision in this case, petitioners claim that the court "held that the vested property and contract rights of WRS

[4] Petition at 17.

Participants is limited to their benefit commitments, and does not extend to the assets and earnings contained in the WRS Trust Fund." Petition at 15. This description of the decision is simply wrong.

As explained above, the Wisconsin Supreme Court determined that WRS participants have a right to (a) rights exercised and benefits accrued for service rendered; (b) proper use of the Trust Funds; and (c) the security and integrity of those funds. App. 49-57. However, in this case, the fact that (i) obligations of employers to fund benefits remain unchanged, (ii) employer reserve monies are used to pay Trust Fund obligations, and (iii) implementation of Act 11 does not cause the WRS to become actuarially unsound led the court to conclude that no contract rights or property interests of petitioners were threatened by the challenged provisions of Act 11.

Petitioners attempt to generalize the so-called "conflicting" state court decisions as either protecting solely the right to receive benefits or protecting the right to receive benefits and having a "property interest in the underlying assets of their pension system." Petition at 16.[5] This is a vast over-simplification and, at the same time, says almost nothing. To say there is a "property interest in the underlying assets of [a] pension system" does nothing to define just what those interests are. The interest to have money deposited into the system? How much? When? Who decides? Or is it the interest in how the money is used? By whom? When? For what purposes? Contrary to petitioners' implied suggestion that these questions are answered the same way by those state courts in "one camp," and a different way by all those state courts in the "other camp," this is simply not how the cases work. Public pension systems are often complicated. They are certainly not the same from one state to the next. For each case in which

[5] Interestingly, petitioners cited not a single one of these cases in the several briefs they filed with the Wisconsin Supreme Court in support of their positions in this case.

changes to a system are not allowed, one can find other cases where changes to the system *have* been allowed.

The decision below is not in conflict with, but rather distinguishable from the decision in *McDermott v. Regan*, 82 N.Y.2d 354, 624 N.E.2d 985 (1993). In New York, rights in the public employee retirement system are established by the New York constitution. In Wisconsin, they are established by statute. In New York, the change from one funding system to another divested control from the state comptroller as trustee of the fund; in this case, the statute specifically preserves the trustees' obligation to ensure proper actuarial funding of the WRS. 82 N.Y.2d at 360-61; App. 79. In New York, the only factor considered by the legislature when it chose to alter the funding method was the fiscal crisis facing the state. 82 N.Y.2d at 362. In Wisconsin, there is no evidence that the modification was anything other than one of the various aspects of funding the increased benefits provided for in Act 11. In New York, there is no requirement to consider the "price" of fulfilling benefit commitments. In Wisconsin, ch. 40 requires administration of the Trust Fund to fulfill benefit commitments "at the lowest possible cost." Wis. Stat. § 40.01(2).; App. 78; 142. In New York, the record included an actuarial study concluding that the new funding method created an inappropriate level of risk. 82 N.E.2d at 361. In Wisconsin, the record included a stipulation that the challenged legislation would not render the Trust Fund actuarially unsound. App. 81.

The facts of *Dadisman v. Moore,* 181 W. Va. 779, 384 S.E.2d 816 (1988), bear no similarity to those at issue in this case. West Virginia statutes provided that the public employee system trustees certify an actuarially-determined funding amount to the Governor, who is required to include that amount in his appropriation bill to the West Virginia legislature. He refused to perform this ministerial duty, and the appropriations were not made. The West

Virginia court found this refusal unconstitutional.[6] Nothing like that occurred in this case. The West Virginia court noted that the legislature impairs contract obligations when it "attempts to change important provisions of an existing contract outside the limits of the reserved state powers." 181 W. Va. at 790. In this case, however, there are specific powers reserved to the state of Wisconsin to make changes to the WRS, and the changes at issue are not outside those reserved powers. Furthermore, subsequent cases in West Virginia made it clear that the court's ruling in *Dadisman v. Moore* did not preclude every legislative change to the public employee pension system in that state, including changes in accounting procedures. *State ex rel. Dadisman v. Caperton,* 186 W. Va. 627, 413 S.E.2d 684 (1991).

In *Valdes v. Cory,* 139 Cal. App. 3d 773, 189 Cal. Rptr. 212 (1983), the legislation at issue, which suspended payments from the state to the public employee retirement system, was admittedly passed solely to meet the constitutional mandate to balance the state budget. The retirement law required statutorily set payments to be made until the retirement board or the legislature, after due consideration of the actuarial recommendations by the Board. No such input was obtained by the California legislature. 139 Cal. App. 3d at 787. In Wisconsin, there is no such requirement. However, even if there was, there were actuarial reports prepared in connection with the benefit enhancement legislation which became Act 11. Stipulated Exhs. 12, 13. Furthermore, in the WRS, the monies set aside for the employer credit were always destined to be deposited into the employer reserve, and in fact would have all been deposited there within

[6] The Court ordered an actuarial determination and repayment of any underfunding of the system produced by these missed appropriations. In *State ex rel. Dadisman v. Caperton,* 186 W.Va. 627, 413 S.E.2d 684 (1991), the court determined that no "replacement" appropriations were necessary because the actuary did not determine that the system was rendered actuarially unsound by the underfunding which was the subject of *Dadisman v. Moore*. Furthermore, the *Caperton* court found that a legislative change to the accounting in the system which eliminated underfunding for one set of employees by applying the overfunding of another set of employees in the system did not violate any contract rights or property interests of system participants.

five years, when the TAA is set to terminate. And those deposits would, in turn, have always reduced the amount of payments made by the employers into the employer reserve account. The only change was to the timing of that reduction – immediately, or over a number of years as a change in the employer contribution rate. App. 111 ¶ 55; App. 77-78 ¶¶ 184-86.

In *Weaver v. Evans*, 80 Wash. 2d 461, 495 P.2d 639 (1972), the sharply divided court found that reducing state appropriations to the retirement system due to a state budget shortfall was an impermissible violation of contract. Act 11 was a pension improvement bill which had no relationship to any budget shortfall.[7] It used as part of the funding of WRS obligations a method which had always been used – recognition of investment earnings on the employer reserve to that reserve – but simply changed the effect of a portion of that recognition from one which would change the employers' contribution rate to a more immediate credit.

In *Dombrowski v. City of Philadelphia*, 431 Pa. 199, 245 A.2d 238 (1968), the record indicated that appropriations made by the city were insufficient to maintain the city's retirement system in an actuarially sound condition. By contrast, the record is clear that Act 11 does not render the WRS actuarially unsound.

The *Dombrowski* decision itself explains why it does not "conflict" with the decision below in this case by describing why its decision differs from the one it rendered in *Geary v. Allegheny County Retirement Board*, 426 Pa. 254, 231 A.2d 743 (1967). In *Geary*, the court found constitutional an act which reduced retirement age, thereby allegedly decreasing the actuarial soundness of the retirement fund. In *Geary*, the court determined that a decrease in actuarial soundness by itself is not sufficient to constitute a deprivation of vested rights or an

impairment of contract rights, finding that "a legislative alteration of retirement laws whose only adverse effect on participants is to increase a theoretical possibility that payments to them will not be met is not a sufficiently concrete detriment to constitute a violation of constitutional guarantees." 426 Pa. at 259.

The *Dombrowski* court found *Geary* clearly distinguishable because in *Dombrowski* there was no legislative alteration of the pension plan, there was nothing theoretical about the actuarial unsoundness of the plan, and the issue was not unconstitutional impairment but rather simply an argument that the City was not fulfilling its contractual obligations. Those same three distinctions can be drawn between *Dombrowski* and the present case.

Even in the cases cited by petitioners, the courts acknowledge that changes to the pension systems in those states can be made without a taking and without constituting an unconstitutional impairment of contract. In *Weaver*, the court acknowledged that:

> [a]n employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.

80 Wash. 2d at 476 (citations and quotations omitted; citing decisions from California, Georgia, Pennsylvania and Washington). *See also, State ex rel. Dadisman v. Caperton*, 186 W. Va. 627, 413 S.E.2d 684 (1991). Similar conditions on pension changes are acknowledged in the decision

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[7] Petitioners assert that "there is no legitimate public purpose being served by Act 11" other than budget relief. App. 29. This is incorrect and contradicted by the record in the case. Act 11 was benefit enhancement legislation, which included funding for those benefit enhancements. App. 68 ¶ 153. The record is absolutely devoid of any evidence that Act 11 was passed due to budget shortfalls or for any other reason inconsistent with the mandate of § 40.01(2) to utilize the Trust Fund to fulfill benefit commitments at the lowest possible cost.

below, indicating that there is no "great divide" among the various state decisions. Instead, there is consideration of various changes which, predictably, lead to various results.

Contrary to petitioners' argument, the decision below does not limit protected rights and interests in the WRS to benefit payments; it also ensures proper use of Trust Funds, and maintenance of the security and integrity of the funds. Petitioners' attempt to set up a false conflict among state court decisions is no basis for granting the petition.

II. THE WISCONSIN SUPREME COURT'S DECISION IS CORRECT.

Public pension legislation "enjoys the same strong presumption of constitutionality as any other legislative enactment." *Wisconsin Retired Teachers Ass'n, Inc. v. Employe Trust Funds Bd.*, 207 Wis. 2d 1, 17-18, 558 N.W.2d 83 (1997). Petitioners were unable to overcome this presumption or meet their burden of proving Act 11 constitutional beyond a reasonable doubt.

A. The Wisconsin Supreme Court Properly Defined the Contract Rights and Property Interests of Participants in the WRS.

The Wisconsin Supreme Court ruled that WRS participants have a right to (a) rights exercised and benefits accrued for services rendered; (b) proper use of the Trust Funds; and (c) the security and integrity of those funds. App. 49-57.

This bundle of contract rights and property interests in the WRS does not – and should not – render the WRS unresponsive to the needs of its beneficiaries, changing economic conditions, actuarial principles, funding or investment strategies. Petitioners fail to distinguish among the aspects of the WRS which are properly protected contract and property rights, and the

aspects of the WRS which are subject to change and modification without impingement of those protected rights.[8]

One might think from reading the petition that there are many cases describing participants' rights in the WRS which have been ignored by the Wisconsin Supreme Court. In fact, there are relatively few cases specifically about the WRS, and each one was considered by the court and used as a basis upon which to build the decision in this case. App 49-51; 55-57. Indeed, the court relied upon cases addressing predecessor systems as well as other public pension systems besides the WRS. The court distinguished the facts and WRS changes at issue in prior cases from the system enhancements of Act 11. App. 69. However, contrary to the argument made by petitioners, the court has not overruled its previous holdings or ignored them.

B. The $200 Million Employer Credit Account Does Not Violate the WRS Contract, and Thus Does Not Constitute Either a Taking or an Unconstitutional Contractual Impairment.

1. The $200 Million Employer Credit Does Not Violate the WRS Contract.

The Wisconsin Supreme Court determined that the creation of the $200 million employer credit did not constitute any impairment of the WRS contract. App. 80 ¶ 193. Nor did creation of the credit constitute a taking. App. 79 ¶¶ 189-192. The court found that the sole purpose of the employer reserve is to ensure the fulfillment of benefit commitments to participants at the lowest possible cost. App. 72 ¶ 165. To achieve this objective, employers are required to make contributions for current service, and contributions to erase unfunded liability. App. 72 ¶ 166. The employer reserve contains both employer contributions and earnings on those contributions.

[8] Even the "rights exercised" and "benefits accrued" that are specifically "due" for "services rendered" under § 40.19 can be forfeited as a condition for receiving subsequently enacted rights and benefits of equal or greater value. § 40.19(1). In addition, the participants' interest in the integrity and security of retirement funds "does not render every legislative intervention into a retirement trust fund unconstitutional." *Association of State Prosecutors*, 199 Wis. 2d at 563.

The balance in the employer reserve does not determine the benefits received by an annuitant. App. 74 ¶ 172.

The court observed that even if employers paid every penny of unfunded liability, they would still be responsible for future unfunded liability resulting from (1) benefit increases voted by the legislature, (2) new recognitions of past service, and (3) actuarially-based recalculation of liability by the ETF Board. App. 74-75 ¶ 174. However, while the amount of the liability might change, the obligation of employers to fulfill benefit commitments to participants is unchanged by Act 11. App. 75 ¶ 175.

SEA posits that the Trust Fund is more secure with cash reserves than when a portion of those reserves is replaced with a promise of future payment. While the court acknowledges that may be true, the court further points out that chapter 40 explicitly recognizes unfunded liability, allows it to be paid over a 40-year period, and permits adjustment of the amount of such liability by future legislative, economic and actuarial events. App. 76 ¶ 178. While chapter 40 creates absolute liability for accrued benefits, it does not create absolute security for that liability. That would require cash in advance, which the statutes specifically do not demand. *Id.*

The Wisconsin Supreme Court recognized that non-annuitant participants in the WRS have a general property interest in the employer reserve because it is one of the funding sources for future benefits. Non-annuitant participants have the right to protect the integrity and security of the employer reserve so that benefit commitments will be fulfilled. They also have the right to limit use of the monies to Trust Fund purposes. App. 79 ¶ 190.

However, these non-annuitant participants do not have a right to require more than is necessary to fulfill benefit commitments over an actuarially-determined period of time. The Trust Fund Board's mandate to maintain proper actuarial funding of the WRS was not eliminated

in Act 11, it was reinforced. 1999 Wis. Act 11 § 27(3); App. 79 ¶ 191. Further, the record established by stipulation is that implementation of Act 11 will not leave the Trust Fund actuarially unsound. App. 121 ¶ 54; App. 135.

2. The $200 Million Credit Is a Proper Trust Fund Purpose

The establishment of the employer credit account is a proper Trust Fund purpose. Section 40.01(2) requires that the Trust Fund, which includes the employer accumulation reserve, be "managed, administered, invested and otherwise dealt with solely for the purpose of ensuring the fulfillment at the lowest possible cost of the [ch. 40] benefit commitments to participants." The establishment and use of the employer credit account within the employer accumulation reserve is a vehicle by which the reserve is managed, administered and dealt with to ensure fulfillment of benefit commitments "at the lowest possible cost." App. 78 ¶ 186.

This is not a situation where funds were directed into the employer reserve that would not have always gone there. In fact, with the elimination of the TAA, all monies in the TAA are distributed to the employer, employee and annuity reserves over 5 years. Thus, the question is not whether the employer credit monies would have been recognized into the employer reserve, but only when such recognition would occur.[9]

In addition to the change in timing, the employer is permitted to take an immediate credit rather than simply take advantage of the likely reduction in contribution rates that this recognition would have eventually created. If the $200 million were not applied as a credit

[9] Contrary to petitioners' implications, this is not the first time that the legislature has established an employer credit within the employer accumulation reserve. In 1989, pursuant to 1989 Wis. Act 13, § 47(2), the Legislature authorized – if recommended by the ETF consulting actuary – the use of the employer accumulation reserve's portion of the special $500 million transfer, after the liabilities created by 1989 Wis. Act 13 (primarily for early retirement) had been funded, for credits to individual employer's unfunded prior service liability accounts. However, all of the portion of the $500 million transfer credited to the employer accumulation reserve was necessary to fund liabilities created by 1989 Wis. Act 13, and no amounts were therefore allocated as credits toward any employer's unfunded liability under that provision of Act 13. App. 116 ¶ 35.

toward payments due from participating employers for unfunded liability or current contributions, it would be part of the total balance of the employer reserve considered by the actuary as one of several factors to determine contribution rates. App. 123 ¶ 59. Although standing alone and in the absence of other influences it would not have an immediate change in contribution rates, its impact upon employer contributions would simply be deferred and affect the next evaluation of contribution rates. App. 123 ¶ 60. However, the manner in which the recognition of $200 million of investment earnings in the employer accumulation reserve of the Trust Fund influences employer contributions to the WRS is *not* a protected contractual or property right of the petitioners. Every dollar of earnings that is recognized into the employer accumulation reserve eventually impacts the contribution rate, and therefor the amount of future employer contributions. App. 77 ¶ 184. Employer contribution rates have been reduced before as a result of favorable investment results for both current and unfunded liability. App. 32 ¶ 51.

Also contrary to petitioners' assertions, the employer credit account monies will be used solely to fulfill benefit commitments to WRS participants, as required by § 40.01(2). The monies are not removed from the WRS and paid over to someone other than WRS participants, as was the case in *Association of State Prosecutors v. Milwaukee County*, 199 Wis. 2d 549, 544 N.W.2d 888 (1996). The monies stay in the Trust Fund and are used to pay annuities to eligible participants. App. 79 ¶ 192. That is how the employer accumulation monies have always been used. Act 11 does not change that use of the monies.

Furthermore, the parties agree that the Trust Fund is actuarially sound; that it is not financially troubled, and implementation of Act 11 by itself will not make it so. Thus, the security of the fund is not threatened by the proposed application of the $200 million credit account. App. 70 ¶ 160; App. 81 ¶ 197; App. 121 ¶ 54; App. 135.

3. The Amount of An Employer's Unfunded Liability and the Method of Payment Therefor is Not a Protected "Contract Right" or "Property Interest."

As the Wisconsin Supreme Court observes, Act 11 does not abrogate the statutory and constitutional obligation of employers to fulfill benefit commitments to participants. App. 75 ¶ 175. Petitioners claim a property interest in the employer reserve, and a contract right in a particular regimen of funding, even though the challenged changes will not threaten the actuarial soundness of the Trust Fund. App. 75 ¶ 176.

But petitioners are not entitled to absolute security. They are, instead, entitled to absolute liability. App. 76 ¶ 178. This is so in part because the dollar amount of liability will change based upon actuarial factors and participant choices. Factors affecting the dollar amount of liability include investment results, benefit changes, number of employees, salary levels, and the benefits each participant chooses.

The unfunded liabilities of employers under the WRS are not absolute, unchanging amounts.[10] The unfunded liabilities of employers have been recalculated several times. These

[10] In *Columbia County v. Board of Trustees of Wis. Retirement Fund*, 17 Wis. 2d 310, 116 N.W.2d 142 (1962), the court held that the payment of employer contributions based upon past service credits is a contingent liability, the amount which at any given time is not absolute. *Id.* at 328.

The *Columbia County* court explained:

> The amount of the obligation to finance the pension involves so many variable factors that the obligation of a county must be redetermined each year on an actuarial basis in the light of changing contingencies. . . .
>
> The obligation for past service credits is not ascertainable for any period of time except for the convenience of making payments during a given year. The best that can be said is that the obligation is to pay some amount which varies. Such an obligation is distinctly different in nature from a bond issue or a contracted obligation whereby the obligor has received the consideration, the principal amount is certain, and is to be paid over a definite period of years, in stated amounts. . . .
>
> The prior-service-credit obligation is uncertain and indefinite in amount and necessarily will continue to be so. The nature of such an obligation is not a debt within the meaning of sec. 3, art. XI, Wis. Const.

recalculations follow adjustments to the actuarial assumptions that govern overall funding requirements for the WRS. In 1989, when the actuary recommended (and the ETF Board approved) changing the assumed rate from 7.5% to 7.8%, the DETF recalculated the remaining unfunded liabilities using the new assumed rate. As a result, the aggregate unfunded liabilities of all employers as carried on DETF's books, was reduced by $90,589,521. In 1991, when the actuary recommended (and the ETF Board approved) changing the assumed rate from 7.8% to 8.0%, the DETF recalculated the remaining unfunded liabilities using the new assumed rate. As a result, the aggregate unfunded liabilities of all employers as carried on DETF's books, was reduced by $59,477,500. In 1994, when the actuary recommended (and the Board approved) changing the across-the-board salary increase assumption from 5.6% to 5.3%, the DETF recalculated the remaining unfunded prior service liabilities of employers, using the new salary inflation assumption. As a result, the aggregate unfunded liabilities of all employers as carried on DETF's books was reduced by $85,117,420. App. 115 ¶ 33.[11]

Act 11, § 15, creates Wis. Stat. § 40.05(2)(cm), which clarifies that the DETF may adjust the unfunded liability of each employer to reflect changes in the assumed rate and the assumption for across-the-board salary increases, and any other factor specified by the actuary if the actuary recommends and the ETF Board approves the changes or if otherwise provided by law. Stipulated Exh. 1, p. 3 at § 15.[12]

> In this case, the county's obligation is conditioned upon future contingencies which under the pension plan will affect the amount of the annual payments.

Id. at 329-330.

[11] In 1999, the ETF Board took the position that it had no statutory authority to adjust the employer's unfunded liability balance even when the WRS actuary subsequently recommends changes in the actuarial assumptions that were used when the initial unfunded liability balance was determined. App. 115 ¶ 34; App. 235-247.

[12] In fact, since the Stipulated Facts were submitted, the Trust Funds Board has announced on June 30, 2001 that based upon investment results, contribution rates will again decrease for 2001.

Not only is the amount of employers' unfunded liabilities subject to adjustment (just as contributions for current service are influenced by actuarial assumptions which respond to changes in the WRS experience); there is evidence in the record supporting an argument that the unfunded liability does not really exist at all. According to the Joint Survey Committee Report on 1999 A.B. 495 (which was ultimately enacted as Act 11), the unfunded liability measured now at approximately $2.2 billion is really a "fictitious debt." According to the Report:

> The $2.2 billion in current "Unfunded Accrued Liability" charged against Wisconsin's public employers exists only because state statutes require the use of an archaic definition of Unfunded Accrued Liability known as the "Frozen Initial Liability Cost Method." Very few, if any, other states still use this method. Most use some version of the "Entry Age Cost Method", under which Wisconsin's public employers would actually have a fully funded retirement system – meaning no "Unfunded Liability" at all. It may seem like accounting sleight-of-hand, but the truth is that the only reason this $2.2 billion debt exists for the employers is that this archaic cost method is still written into statute. . . . This debt is only a debt because the law says it is. There is no logical reason whatever to believe in it.

(Emphasis in original). SEA Wisconsin App. at 91, 97. According to the Report, the WRS employers' liability is overstated by $2.4 billion. SEA Wisconsin App. at 97. This confirms that while there is a protected interest in adequate funding to pay contractually-promised benefits, it is appropriate to maintain flexibility on calculating and funding benefit obligations.

CONCLUSION

The constitutional protection of property interests and contract rights still start with the same analysis: how are the property interests and contract rights defined under state law? The contract rights and property interests of petitioners have been clearly defined by the Wisconsin Supreme Court. Contrary to petitioners' representations regarding the decision of the Wisconsin Supreme Court in this case, that Court did not limit the interests of participants in the Trust Fund to benefit commitments. The Court reaffirmed the interest of the participants in the Trust Fund

itself; to proper use of Trust Fund monies, and to the integrity and security of the Trust Fund. The factual record in this case does not support petitioners' allegations of impairment.

The fact that the Wisconsin Supreme Court differentiated the facts of this case (facts *admitted* by petitioners) from other cases heard by it in the past does not represent some "radical departure" from its previous holdings. For the reasons stated herein, the petition should be denied.

Respectfully submitted,

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